



Smallco Investment Fund

Quarterly Update 31 December 2016

SIF Portfolio Commentary

Smallco Investment Fund (SIF) fell 6.9% in the December quarter and was up 3.3% over the past year. For the quarter the Small Ordinaries Index was down 2.5% and for the year up 13.2%. Since inception SIF has had strong performance up 14.2% p.a. versus the Small Ords 5.5%. Over the last 5 years the Funds 27.8% p.a. compares even more favourably to the Small Ords 4.9%. This performance has come from a focus on selecting good quality industrial companies with perceived strong medium to long term earnings outlooks.

For over a year, we have been commenting that good quality industrial stocks have appeared highly priced by historical standards. In the December quarter, US 10 year bond yields rose significantly (from 1.6% to 2.4%, up 50%). Additionally the US Federal Reserve lifted interest rates and is forecasting a further three rises in 2017. Combined with US President-elect Donald Trump's pledge to "rebuild America" this has resulted in the equity markets doing a "sector rotation" from "growth" stocks to "cyclical" stocks. In general this is a rotation from good quality stocks – the bulk of our portfolio - to lesser quality stocks whose earnings are less predictable, have a higher probability of being downgraded and consequently are poorly represented in the Fund. Included in cyclicals are the Small Resources which are up 59.5% for the year and to which the Fund has no exposure.

Of our significant holdings, Webjet (WEB) had a positive trading update during the quarter. Revenue from the webjet.com.au site continues to grow well above industry growth rates driven primarily by strength in international flight bookings as these bookings move on-line and away from traditional travel agents. We believe that this trend has a number of years to play out given the low penetration of on-line in international vs domestic bookings. WEB also reported a better than expected initial contribution from Online Republic (aggregator sites for car hire, cruises, motorhomes), which was acquired in June. The longer term driver for WEB is the emergence of its B2B division which originates and aggregates hotel inventory and sells to travel agents and on-line travel agents in a streamlined online portal. WEB has established a global platform in this sector and is rapidly gaining market share from the sector incumbents. Earnings from this division are expected to increase from c. 20% of FY17 group profit to close to half of group earnings in FY20. Importantly a large part of this growth is already secured through a contract won with Thomas Cook to provide its hotel inventory in Europe from 2019.

Smallco aims to achieve high compound returns in the Fund by investing in the stock market. We believe that it is easier to achieve this aim by limiting the size of the Fund. To this end, Smallco has decided it will not accept any applications for

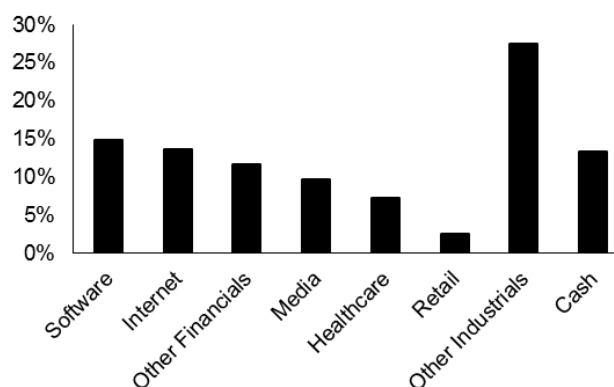
units in the Fund from new or existing investors effective 1 February 2017. Please note that the distribution reinvestment policy will continue (distributions are automatically reinvested in the Fund for investors who have elected reinvestment on 30 June each year). Smallco also reserves the ability to issue units to persons associated with it.

SIF Performance

Return to 31 December 2016	
3 months	-6.9%
1 year	3.3%
3 year p.a.	14.7%
5 year p.a.	27.8%
10 year p.a.	8.6%
Since inception (31.10.00) p.a.	14.2%
Value of \$100,000 invested at inception	\$858,920

Fund returns calculated after all fees and expenses and based upon exit price and reinvestment of distributions.

SIF Structure: by sector (look through)



SIF Significant Holdings (alphabetical order)

Altium
Corporate Travel Management
GTN
Speedcast International
Webjet



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SIF Fund Description

SIF is a concentrated, index unaware Australian equity fund investing predominantly in smaller listed companies. In addition SIF may invest in cash when opportunities are scarce and invest up to 20% of the fund in larger Australian listed companies (within the ASX 100).

Smallco believes that higher returns are available from smaller companies as these companies are generally not as well followed by the market which in turn makes mispricing more common. Particular focus is placed upon companies with a market capitalisation of between \$100m to \$500m - the Smallco "sweet spot".

SIF typically holds 25 to 35 stocks on the premise that it is better to have a holding of core stocks that offer solid investment fundamentals than a large number of "OK" investments.

Smallco's dominant investment tool is fundamental analysis. Focus is placed upon internal financial modelling supplemented by some broker research. We are strong believers that earnings are the key driver of share prices and as such, the greater the accuracy in forecasting earnings the more consistent the outperformance.

Stock weightings within the portfolio are determined by the assessment of the quality of the stock, the likely investment outcome, liquidity and the risk of sustained capital loss.

SIF very rarely invests in mining stocks, is very averse to loss making companies, and takes an extremely cautious approach to biotechs and structurally impaired industries.

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Key Investor Information

Strategy	SIF is a concentrated, Australian equity smaller company focused fund that invests predominantly long but can effectively short when opportunities are found.
Process	Smallco manages SIF employing a bottom up fundamental research approach focusing upon earnings direction, risks and the underlying businesses quality.
FUM	\$342.4m AUD
Mid Price	\$4.7020 (30 Dec 2016)
Distribution	Annually 30 June
Inception Date	31 October 2000
Portfolio Managers	Rob Hopkins, Bill Ryan, Andrew Hokin, Paul Graham and Craig Miller
APIR Code	ASC0001AU
Minimum Initial	\$40,000
Buy/sell costs	+/- 0.45%
Management Fee	1.40% of net assets *
Administration cost (FY16)	0.16% of net assets *
Performance Fee	18.64% of the performance above the Fund's previous end-of-six-month period high. Payable 6 monthly. *
Service providers	Custody: JP Morgan Administration: White Outsourcing
Liquidity	Time to exit 50% of SIF assets: < 1 day

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This document does not take into account the investment objectives, financial situation and particular needs of each reader. Accordingly, nothing in this document should be construed as a recommendation by Smallco, or any associate of Smallco or any other person, concerning an investment in the fund.

* Unless otherwise stated, all fees quoted are inclusive of GST, after allowing for an estimate for Reduced Input Tax Credits (RITC). Past performance is not a reliable guide as to future performance. Returns are not guaranteed.